In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 482

STEPHEN F. HERINGER, MABEL H. HERINGER, JOHN F. HERINGER, AND ALTA G. HERINGER, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 84–89) are reported at 21 T. C. 607. The opinion of the Court of Appeals (Pet., App. A) is reported at 235 F. 2d 149.

JURISDICTION

The judgment of the Court of Appeals was entered on June 7, 1956. (Pet., App. B). A petition for rehearing was filed on June 29, 1956 (Pet., App. D) and was denied by the Court of Appeals on July 9, 1956 (Pet., App. C). The petition for a writ of certiorari

We shall be happy, without further belaboring this Court here or at this time to submit orally or in written memorandum form what we believe are additionally helpful, pertinent, and convincing authorities to support the foregoing views.

Dated, San Francisco, California,
June 29, 1956.

Respectfully submitted,
R. E. H. Julien,
Attorney for Petitioners.

Denied July 9, 1956
Mandate July 16, 1956

CERTIFICATE OF COUNSEL.

I hereby certify that in my judgment the within petition for rehearing is well founded and is not interposed for delay.

R. E. H. Julien,
Attorney for Petitioners.

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was filed October 6, 1956. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Taxpayers, two brothers and their wives, conveyed gifts of land to a corporation of which they and their respective children were the only stockholders. The question presented is whether the Court of Appeals erred in holding the interests of the non-contributing stockholders (*i. e.*, the eleven children) to be "future interests" within the meaning of Section 1003 (b) (3) of the Internal Revenue Code of 1939, thereby precluding each donor from claiming a $3,000 exclusion for each year for each of the non-contributing stockholders and, instead, allowing each donor only one exclusion in each year for the transfer to the corporation.

STATUTES AND REGULATIONS INVOLVED

Sections 1000 (a) and (b), 1003 (b) (3), 3797 (a) (1) of the Internal Revenue Code of 1939 and Section 86.11 of Treasury Regulations 108 are printed in the Appendix, *infra*, pp. 9–10.

STATEMENT

The facts as found by the Tax Court (R. 85–88) and stated by the Court of Appeals may be summarized as follows:

Stephen F. Heringer and John F. Heringer, two brothers, and their respective wives, Mabel H. Heringer and Alta G. Heringer (hereinafter called taxpayers), together owned approximately 2,074 acres of farm land in Sacramento County, California.

On or about January 5, 1948, taxpayers caused to be incorporated Vorden Farms, Inc. (hereinafter called the corporation), for purposes of conducting a farming and agricultural business. On or about December 8, 1948, the corporation issued 50,000 shares of stock, at one dollar per share. Taxpayers each purchased 5,000 shares, a total of 20,000 shares or forty per cent of the shares issued. The two couples together have eleven children, who separately purchased, for cash, the remaining 30,000 shares; Stephen's six children each purchased 2,500 shares, while John's five children each purchased 3,000 shares.

On December 28, 1948, taxpayers transferred to the corporation a one-half interest in the farm lands owned by them and on January 5, 1949, conveyed the remaining one-half interest. No consideration for the transfer was given or promised; the fair market value of the land was $641,443.

The corporation leased the land to a partnership, comprised of nine of the eleven children, which farmed the land. The corporation collected rents from the partnership, paid taxes and assessments and distributed dividends. Officers of the corporation received no salaries. Prior to the existence of the corporation, the partnership had leased the land from the taxpayers.

Taxpayers filed gift tax returns for the years 1948 and 1949, taking the position that no taxable gift was involved; but that, if there was a gift, the donors retained a forty per cent interest in the property transferred and each donor was entitled to eleven

exclusions for gift tax purposes, *i. e.*, an exclusion for each of the non-contributing stockholders. The Tax Court rejected these alternative contentions, holding the transfer to be a taxable gift to its full extent and each taxpayer entitled to but one exclusion for each year. The Court of Appeals affirmed the Tax Court's finding that the transfers were gifts within the intent of the statute, but agreed with taxpayers' contention that the amount of the gift was not the full fair market value of the property at the time of the transfers, but only sixty per cent thereof (by reason of taxpayers' forty per cent ownership of the corporation). Finally, the Court of Appeals held the interests taken by the non-contributing stockholders to be "future interests" within the meaning of the statute and, accordingly, affirmed the Tax Court's holding that the taxpayers were not entitled to exclusions for gifts to each of the children, but that each was entitled to but one exclusion for each year.

ARGUMENT

The sole issue presented by the petition involves the number of annual exclusions to which each donor is entitled with respect to gifts made to a corporation.[1] (Pet. 4–6.) The Court of Appeals held the interests of the non-contributing stockholders to be "future

[1] The Court of Appeals decided the issue of whether the transfers in question were gifts or capital contributions in favor of the Commissioner, and taxpayers have not raised this issue in their petition to this Court. The question of the amount of the gift was decided in favor of the taxpayers, and the Commissioner has abandoned that issue.

interests" within the meaning of the statute in question, thereby precluding each donor from claiming a $3,000 exclusion for each year for each of the non-contributing stockholders and limiting each donor to one exclusion in each year for the transfer to the corporation. This holding is clearly correct and taxpayers are unable to cite any authority to the contrary. There is no conflict of decisions and there are no other grounds calling for further review.

Section 1003 (b) (3) of the Internal Revenue Code of 1939 (Appendix, *infra.* p. 9), which establishes the annual exclusion of $3,000 for each donee from the amount of taxable gifts, clearly excludes gifts of future interests in property from its provisions. As the Court of Appeals correctly noted, the term "future interests," as used in the statute, is not to be considered as limited to the classic concepts of the common law. The test is whether the donee is given present power of possession or enjoyment of the gift, or must wait for some future time for such possession or enjoyment. *United States* v. *Pelzer,* 312 U. S. 399; *Ryerson* v. *United States,* 312 U. S. 405; *Commissioner* v. *Wells,* 132 F. 2d 405 (C. A. 6th); *Fisher* v. *Commissioner,* 132 F. 2d 383 (C. A. 9th). See Treasury Regulations 108, Sec. 86.11 (Appendix, *infra,* p. 10).

Here the gift was to the corporation, and the shareholders could possess or enjoy the land or income therefrom only upon the occurrence of some future event, *e. g.,* the declaration of dividends by the corporation, the liquidation of the corporation, or sale

of the stock. Furthermore, the declaration of dividends required the joint action of members of the corporate body. This provided a further condition and element of postponement of possession and enjoyment of the gift. See *Ryerson* v. *United States, supra.* The taxpayers, having elected to do business as a corporation and to transfer the land to the corporation, must accept the tax disadvantages of their action. See *Gray* v. *Powell,* 314 U. S. 402, 414; *Higgins* v. *Smith,* 308 U. S. 473, 477.

Taxpayers contend that since the Court of Appeals held that the value of taxpayers' holdings was proportionately increased as a direct result of the gift to the corporation, it follows that the value of the holdings of the non-contributors likewise increased. Therefore, they argue, their interests must be deemed present rather than future. (Pet. 4–5.) The fallacy of this reasoning is apparent. The question of the increase in value of the donors' stock was considered for the purpose of determining whether the amount of the gift was the full fair market value of the property or sixty per cent thereof, *i. e.,* whether the donors in effect received consideration in the amount of forty per cent of the value of the property. The Court of Appeals, in deciding this question in favor of taxpayers, viewed the problem in connection with the provisions and purposes of the estate tax statute, and held that the taxpayers' intention was to donate sixty per cent of the property and that they parted with no more. The question of the number of allowable exclusions, however, involves an entirely different

issue, *i. e.*, whether the donees have the present power of possession and enjoyment of the property. There can be no doubt that the book and economic value of the stock held by the non-contributing stockholders increased by reason of the gift as did that of the taxpayers; but it does not follow that the interests of the stockholders are present, rather than future, within the meaning of the statute. For the reasons already discussed, the interests are clearly future and the decision with respect to the exclusions correct.

Taxpayers' contention (Pet. 5–6) that the only appropriate issue for adjudication before the Court of Appeals was whether the noncontributing shareholders were the real and intended donees[2] and that the court erred in considering the issue of "future interests" is likewise without merit. The Commissioner was free to urge any matter appearing in the record in support of the judgment and to sustain such judgment upon any valid legal ground. *Ryerson* v. *United States, supra; LeTulle* v. *Scofield,* 308 U. S. 415; *Helvering* v. *Gowran,* 302 U. S. 238. The statutory provision under which taxpayers seek the exclusions in question (Section 1003 (b) (3) of the Internal Revenue Code of 1939) clearly sets forth the legal ground relied upon by the Court of Appeals in denying the exclusions, and the record amply supports the findings of fact on this point. The "future interests" contention was fully set forth by the Commis-

[2] The Court of Appeals found it unnecessary to rule upon the factual question of whether the children were the intended donees (R. 128, 129).

sioner in his brief before the Court of Appeals and taxpayers did not seek to refute it (Pet. 5) until after the court's decision, when taxpayers filed a petition for rehearing (Pet., App. D).

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

J. LEE RANKIN,
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NOVEMBER, 1956.

APPENDIX

Internal Revenue Code of 1939:

SEC. 1000. IMPOSITION OF TAX.

(a) For the calendar year 1940 and each calendar year thereafter a tax, computed as provided in section 1001, shall be imposed upon the transfer during such calendar year by any individual, resident or non-resident, of property by gift. Gift taxes for the calendar years 1932–1939, inclusive, shall not be affected by the provisions of this chapter, but shall remain subject to the applicable provisions of the Revenue Act of 1932, except as such provisions are modified by legislation enacted subsequent to the Revenue Act of 1932.

(b) The tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; but, in the case of a non-resident not a citizen of the United States, shall apply to a transfer only if the property is situated within the United States.

(26 U. S. C. 1952 ed., Sec. 1000.)

SEC. 1003. NET GIFTS.

* * * * *

(b) *Exclusions from Gifts.*

* * * * *

(3) [as added by Section 454, Revenue Act of 1942, c. 619, 56 Stat. 798] *Gifts after 1942.*—In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year 1943 and subsequent calendar years, the first $3,000 of such gifts to such person shall not, for the pur-

poses of subsection (a), be included in the total amount of gifts made during such year.

(26 U. S. C. 1952 ed., Sec. 1003.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

(1) *Person.*—The term "person" shall be construed to mean and include an individual, a trust, estate, partnership, company, or corporation.

* * * * *

(26 U. S. C. 1952 ed., Sec. 3797.)

Treasury Regulations 108, promulgated under the Internal Revenue Code of 1939:

SEC. 86.11 *Future Interests in Property.*—No part of the value of a gift of a future interest may be excluded in determining the total amount of gifts made during the calendar year. "Future interests" is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time. The term has no reference to such contractual rights as exist in a bond, note (though bearing no interest until maturity), or in a policy of life insurance, the obligations of which are to be discharged by payment in the future. But a future interest or interests in such contractual obligations may be created by the limitations contained in a trust or other instrument of transfer employed in effecting a gift. For the valuation of future interests, see section 86.19 (*g*).

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